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Report Highlights:

Despite its relatively small population, the rapidly growing wealth of emerging city markets (ECMs) in Inner Mongolia and their proximity to Beijing make them potential destinations for U.S. products. Key cities of interest are Hohhot, Baotou and Erdos.

Executive Summary:

Despite its relatively small population, the growing wealth of emerging city markets (ECMs) in Inner Mongolia and their proximity to Beijing make them potential destinations for U.S. products. The retail sector in the region is significant and has potential for rapid growth as supermarkets expand and upgrade. Hotel food service is another potential market for U.S. food distribution in the region. Consumers are price sensitive, but a growing number of wealthy urbanites in Hohhot, Baotou, and Erdos are willing to pay for high-quality imported food and beverages. Erdos, not well known outside of China, is of particular interest due to unusually favorable demographics. Currently, a lack of knowledge of U.S. products in the region, along with price, are the main barriers to increased sales. Other problems are the limitations of current distribution systems and the lack of market access for U.S. beef.

Background:

Lying just beyond the Great Wall, Inner Mongolia is both a short flight and a world away from Beijing. It is also the closest part of China's "West" to the capital. Despite being China's third largest province in size, Inner Mongolia has a population of only 24 million. With its small, widely dispersed population and historically low incomes, Inner Mongolia has nt been perceived as a destination for agricultural exports. However, with incomes growing rapidly, the urban centers of Inner Mongolia represents a potential market for U.S. food exports. At present, U.S. products constitute only a small share of the import food items currently available in the region.

Note: All values have been converted to U.S. dollars based on the exchange rate of 6.775 yuan per dollar prevalent during the preparation of this report, except where stated otherwise.

ECM Introduction/cities:

Table I: Inner Mongolia and its three largest cities

	Population (millions)	Urban population (millions)	GDP per capita (US Dollars)	GDP per capita Growth	Urban Disposable Income Per Capita (USD)	Urban Food & Beverage Expenditures per capita	Distance to Port of Tianjin (km)
Inner Mongolia	24.2+	12.5*	$5,937+	16.5% +	$2,130*	$524*	
-Hohhot	2.7*	1.1	$7,322	12.2%	$2,992	$609*	654
-Baotou	2.5*	1.4	$10,333	17.8%	$3,079	$787*	835
-Erdos	1.6*	0.24	$15,074	19.0%	$2,869	$619*	946
Beijing	17.6+	14.4*	$10,153 +	6.2%+	$3,649*	$821*	175
Xi'an	7.7*		$3,876*	14.5%	$2,245*	$646*	1,161

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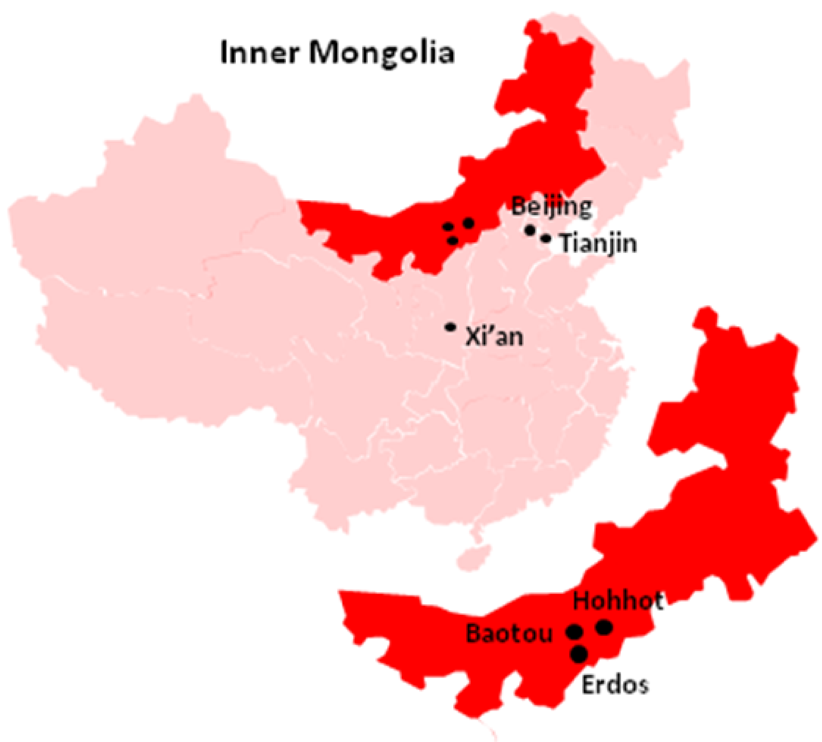
Source: Inner Mongolia Statistical Yearbook, 2009, except: *China Statistical Yearbook for the Regional Economy, 2009; and +China Statistical Abstract, 2010

Technically classified as an Autonomous Region on the level of a province, at 1.2 million square kilometers Inner Mongolia is somewhere between the size of Texas and Alaska. Its dry cool climate supports grasslands in the East and deserts and scrub-land in the West, with an agricultural economy based primarily on livestock herding. For much of Chinese history, Inner Mongolia was a frontier region separated from the rest of China by the Great Wall. The central-west portion of Inner Mongolia consists of agricultural plains and small to medium-sized cities along the Yellow River. The largest three cities – Hohhot, Baotou, and Erdos – are less than a one-hour flight from Beijing. The official population of these three cities amounts to 6.8 million, or 28% of the region's total population. They also produce 60% of the region's GDP and contain most of the steel production, coal mining, and construction activity in the province. Due to their importance to the Inner Mongolian economy, these cities present the best opportunities for U.S. agricultural exports in the region.

These cities are also exceptionally wealthy. Relative to Beijing or the major inland city of Xi'an, Hohhot, Baotou, and Erdos are small with populations of just 2.7, 2.5, and 1.6 million, respectively. However, in terms of urban disposable income, each is roughly 80% of the level of Beijing. By comparison, Xi'an has a disposable per capita income level of $2,250, only 62% of that of Beijing. Each of these three cities also lies relatively close to the port of Tianjin, the primary access point for U.S. products entering Northern China. It is the proximity of these cities to Beijing and their growing affluence that makes them attractive markets for U.S. products.

Hohhot



As the capital of Inner Mongolia, Hohhot has the largest population and the most diverse economic. While its GDP is lower than Baotou, its service sector, including food service, is slightly larger. Government receptions, professional conferences, universities, business meetings, and increasing amounts tourism bring more visitors to Hohhot than to other cities in Inner Mongolia. These visitors pushed hotel and restaurant sector revenues to $1.9 billion, putting it ahead of Baotou or even the much larger city of Xi'an. Hohhot is the center for dairy processing in Inner Mongolia.

Hohhot is also the most accessible major city for imports in the region. At a distance of about 500km from Beijing, Hohhot is the closest city to the national capital and has easy access via the Beijing-Tibet Highway. However, frequent traffic jams caused by coal shipments have complicated Hohhot's access to Beijing and pose a logistics problem for the entire region. Construction is continuing on new road and rail routes to Beijing that are expected to alleviate congestion in the coming years.

Baotou

Baotou is an industrial city lying close to the Yellow River. The steel manufacturer, BaoGang, is at the core of the city's economy. Built on designs made by Soviet planners in the 50s, Baotou is open with large avenues that connect city districts separated by large parks and low-density housing developments. The industrial sector makes the city more affluent than the slightly larger Hohhot. Per capita food and beverage expenditure is $787 compared to Hohhot's $609. Yet, with fewer visitors, the hotel and restaurant sector is slightly smaller than Hohhot's with only $1.7 billion in revenues.

Erdos

As a coal and mineral boom-town, Erdos has experienced rapid growth over recent years. With a GDP per capita of $15,000 and 19% growth in 2008, the region has acquired national recognition for its newly acquired wealth, although a considerable portion of the massive revenues from mining flow out of the city. Urban disposable income in 2008 remained just behind Baotou and Hohhot, though still ahead of Xi'an. Urban expenditures on food and beverages also lag Baotou at $619 per person. Much of Erdos' urban expenditure occurs in the district of Dongsheng, which lies more than 20km away from the official city center. It is here that the high-end restaurants, large hotels, and major supermarkets are located. Officially, Dongsheng contains only 250,000 of Erdos' 1.6 million people, but it is the de facto economic center of the city. Despite having less than 1/6th the city's population, wholesale and retail sales revenues in Dongsheng totaled $1.7 billion or 55% of the total for Erdos. Restaurant sector revenues in Dongsheng were $215 million, or roughly 30% of the total for Erdos.

Retail

Table II: Retail, HRI and Tourism Revenues, by City

	Retail & Wholesale Sales (billions USD)	Hotel and Restaurant Revenues (billions USD)	Hotel Sector Revenues (million USD)	Overseas Arrivals (thousand person-times)	Earnings from Domestic Tourism (billions USD)
Inner Mongolia	27.3 *	6.8 *	426 #	1,549 *	6.3 *
-Hohhot	5.9 *	1.9 *	153 #	81 *	1.5 *

-Baotou	5.9 *	1.7 *	57 #	18 *	0.9 *
-Erdos	3.1 *	0.7 *	49 #	13 *	0.7 *
Beijing	59.7 *	7.5 *		3,790 *	28.1 *
Xi'an	15.1 *	1.7 *		908 *	3.2 *

* 2008 data, China Statistical Yearbook for the Regional Economy, 2009
# 2008 data, Inner Mongolia Statistical Yearbook 2009

Hohhot, Baotou, and Erdos combined account for $14.9 billion, just over half of the $27.3 billion in revenues for the entire region. The three cities also compare well to the total revenues of $15.1 billion in Xi'an. Yet, when compared to Beijing, Inner Mongolia and its largest cities are still a small and fragmented market.

The retail sector in Inner Mongolia is dominated by single outlet stores and small, local chains. The higher-end supermarkets are typically located in the underground sections of large shopping malls in urban centers. The central location of these stores makes parking a continual problem, but it does bring in foot traffic from shoppers who come to buy clothing, jewelry, electronics, and accessories in the above-ground mall. There is some interest among international supermarket chains in the Inner Mongolian region. Dutch-based SPAR is currently in Hohhot through a joint-venture, and Wal-Mart is rumored to be coming to Baotou.

Most high-end retailers have an exclusive imports section. The size, design, accessibility, and location of the import section are indicators of the attention that the store places on import products. Products in these import sections typically consist of wines, beer, pasta, sauces, olive oil, snack food, cereals, and non-alcoholic beverages. On average, only 5-10% of the products are of U.S. manufacture. Spanish and Italian olive oils; Australian oats; New Zealand, French, and U.S. dairy products; U.S. nuts; and some fruits from Chile, Mexico and the U.S. can often be found on the regular shelves alongside Chinese products.

Exclusive import food stores exist in all three cities. These stores are typically small with 40-120m^2 of space. The manager for a chain of import stores across the region also supplies supermarkets, hence the same products can be found in both. However, the presence of a middleman adds to costs.

The distribution system in Inner Mongolia for imported goods is very inefficient with several middle-men between the importer and the local retailers. As goods change hands, they also frequently deteriorate in quality due to poor handling practices and cold chain infrastructure in the region. For example, at the time of Post's visit in August 2010, it was impossible to bring in chocolates as they would melt in transport.

Hohhot

In Hohhot, Weiduoli (Victory) is at the top of the region's high-end retail sector. With three stores and a larger one under construction, Weiduoli is the dominant provider of imported products in Hohhot. Meitehao, which is partnered with the Dutch retailer SPAR, also has a location in Hohhot featuring a large and well-organized import section. But with only one location, Meitehao-SPAR is more limited than Weiduoli. Wangfujing is present in Hohhot, but its location is small and out-dated and carries a minimal number of imports. Import availability in Hohhot is probably the best in the region though it compares poorly to Beijing.

Baotou

Baotou's retail and wholesale sector is as large as that of Hohhot's with $5.9 billion in revenue. Yet, the situation for imports is more limited by logistics and promotional capacity than that of Hohhot. The best import selection is in YongShengCheng, which is located below a newly built luxury mall. Wangfujing's outlet in Baotou has a very limited focus on import goods and they have opted not to create an import section, instead placing items directly alongside similar Chinese goods. Baotou Department Store, a locally-owned retailer, had a minimal selection, with many items out of stock. Retailers across Inner Mongolia reported irregular shipments and unpredictable changes in demand for imported products leading to stock-outs or unsold merchandise. Also, according to Baotou Department Store's management, there is a lack of knowledge among local chains of how to effectively promote import food and beverage products. Given the dominance of local and regional chains in Inner Mongolia, this knowledge gap would need to be addressed before the region's retail sector can accommodate more import items.

Erdos

Dongsheng district is the economic center of Erdos with 55% of the city's retail & wholesale activity. All of the 5 supermarkets cited in this report were in Dongsheng. The concentration of high-income consumers in Dongsheng district makes it less price-sensitive than Hohhot or Baotou. In four of the five largest high-end outlets, the selection of imported products was comparable to that of high-end retailers in Hohhot. The Meitehao in Erdos had an even better selection than the Meitehao-SPAR in Hohhot, making it the best Post found in Inner Mongolia. With Wangfujing planning to open what is expected to be the largest shopping center in Dongsheng by the end of the year, the retail sector in this district of Erdos shows considerable potential.

According to the supermarket manager of Weiduoli, the rapid growth of Erdos has caused the retail sector to expand faster than storage and distribution infrastructure can support it. Yet, while retail sales of consumer goods in Dongsheng did grow at 26% in 2008, this was similar to the 25% growth experienced by city-level retailers across the region. Post did not note any severe problems with product quality. Import fruits were available in a wider selection and with better quality in some Erdos retailers than in Hohhot supermarkets. Erdos does not seem to face any particular challenges in its import retail sector; rather it has the same challenges of distribution and product knowledge as other cities in Inner Mongolia.

Hotel, Restaurant and Institutional (HRI):

HRI Sector Overview

The hotel and restaurant industry (HRI) sector in Inner Mongolia is relatively small and under-developed compared to first-tier cities like Beijing; however, there is potential for rapid HRI-sector growth. Due to the small population of Inner Mongolia and the marginal economic position of the region, there has been limited attention from luxury hotel or high-end restaurant chains. This is changing with rapid economic growth and growing numbers of tourists in recent years. However, before the HRI sector in Inner Mongolia can become a major consumer of imported food products, it must confront challenges stemming from local preferences and underdeveloped distribution systems.

Despite being a Mongolian autonomous region, the population of Inner Mongolia is majority Han, the dominant ethnic group in China. Han migrants have brought their culinary traditions along with them. , but they have also adapted to the traditional local diet based on beef, mutton and dairy. As these two meat products are widely available in the region and U.S. exports of beef to China are restricted, imports are limited despite the preference for red meat. On the other hand, restoring access for U.S. beef would make grain-fed steaks a potential export to the region's HRI sector.

Due to rapid modernization, the After-80 generation, i.e. the population under 30, represents a large share of the clientele for the restaurant sector in general and particularly for western restaurants and fast food. This holds true for Inner Mongolia as well. According to a manager of the western-themed Shangdao Café (U.B.C. Coffee) who has worked in both Baotou and Erdos, customers to western restaurants in Inner Mongolia are almost entirely under 35 years of age.

Restaurant:

The restaurant sector is quite large in Hohhot and Baotou. With $1.9 billion and $1.7 billion in revenues in Hohhot and Baotou, respectively, the hotel and restaurant sector [1] in each is equivalent to that of the much more populous Xi'an. Erdos, with just $0.7 billion in revenues, is smaller than the other cities, yet the growth rate of 56% in revenues in 2008 in Dongsheng district suggests that the urban restaurant sector is expanding rapidly.

Food service in Inner Mongolia, like in most developing regions of China, is dominated by single outlet restaurants featuring a mixture of local and regional Chinese cuisine. However, international restaurant chains like McDonalds, Pizza Hut, and KFC have opened locations across the region. These popular chains use a minimum of imported items to keep costs low. They also only constitute a small share of the local food service sector. Due to their small numbers and low use of imported items, their impact on imported food demand is minimal, but they do increase interest in more authentic western cuisine and restaurants that do use a larger share of imports.

For western cuisine, Taiwan-based Shangdao Café (UBC Coffee) is the most visible with seven franchise locations in Baotou, two in Ordos, and at least ten in Hohhot. The increased presence of Shangdao Café has been cited as a sign that western food is catching on in the region. While the menu can vary from one franchise to another, most outlets carry a mixture of European, American, Japanese, Korean, and Chinese cuisine. Imported items at locations in Erdos have included pork, beef, cheese, seafood, and alcoholic beverages. Although they admit avoiding imported ingredients whenever possible (e.g. by making their own Chinese-style tomato sauce for pasta), Shangdao Café likely imports more food items than any other major chain restaurant active in the region.

Post also found single-location French, German, Russian, and Japanese-themed restaurants in the cities visited. Yet, those surveyed had a very limited selection of imported products and often carried a mixture of authentic dishes and foreign cuisine prepared Chinese-style with Chinese ingredients. High-end restaurants in the region tended to be ethnic Mongolian or Chinese regional cuisine. Given the limited demand for seafood, poultry, and pork, promoting U.S. products through the restaurant sector may be a challenge. Standalone restaurants in China, particularly in third-tier cities, are highly price-sensitive and reluctant to try new products and distribution channels. By contrast, promotions with hotel-based restaurants provides an opportunity to reach a larger number of high-income and less price-sensitive consumers compared to individual restaurants or medium-priced chains.

HRI

Revenue from the star-rated hotel sector totaled $426 million in Inner Mongolia in 2009. Almost half of that revenue, $204 million, came from hotel-based food service. This is a small amount compared to the region's total hotel & restaurant sector revenue of $6.8 billion. It is also minute in contrast with Beijing's $4.2 billion in total revenues from the hotel sector (limited to firms with annual sales above $300,000). Table II shows the low rates of international visits to Hohhot, Baotou, and Ordos as well as the limited earnings from domestic tourism in these cities in 2008. However, there has been considerable growth in tourism revenues in the region. Between 2005 and 2008, the region's revenue from domestic tourism increased from $2.2 billion (at 2005 exchange rate of 8.2) to $6.3 billion in 2008. Local five-star hotels and international chains like Shangrila and Holiday Inn/Crown Plaza have been moving into the region on the heels of this rapid growth.

Even where these hotels have become established, introducing high-end food service through the hotel sector is a challenge. According to several executive chefs, western food in the hotel sector in Inner Mongolia is limited and customer knowledge is comparable to that of Beijing 30 years ago. Most hotels operate a western restaurant with a buffet selection. Menu service may include Australian steak and a small selection of seafood, but as there is not much of a reputation for these items in the region, they are rarely ordered. Despite having a high-income clientele, hotel buffets must compete on price and managers are reluctant to include imports that are not already in demand. Thus, western cuisine on the buffets in limited to familiar items like pastries, pasta, pizza, and french fries. Breakfast buffets are better attended, but they have the lowest quantity of import items. Lunch and dinner buffets are more often frequented by locals who are not guests of the hotel and thus have more dining choices. The competition between hotels on buffet price is fierce with the highest price buffets at RMB 158 ($23) in Hohhot, RMB 128 ($19) in Baotou, and RMB 180 ($27) in Erdos. Given the higher cost and difficulty of obtaining import items, even western buffets are currently limited to about 5-30%

imported products.

Distribution is a major challenge for the hotels in Inner Mongolia. As the sector is small, it does not generate enough demand to warrant frequent shipments, making imported items available on an irregular basis. Even luxury hotel chains that can source from their own distribution networks often find it necessary to send staff to Beijing to purchase imported items. For products requiring cold storage, distributors exist, but the inadequate cold chain infrastructure often means losses of up to half of the fruit and vegetables shipped. Frequent traffic jams along the main highway to Beijing and Tianjin further complicate distribution. Such difficulties are a strong incentive for hotel restaurants to purchase locally. As products must be transported from Tianjin through Hohhot on to Baotou and then to Erdos, difficulty increases from one city to the next. In spite of this, Shangrila has conducted foreign food-themed promotions in Hohhot in the past, and plans to continue, bringing in Baotou as well. This competitor activity indicates that interest in the region is growing and waiting for the market to catch up with Beijing may not be the best strategy.

Hohhot

Because it receives more government and business receptions, tour groups, and professional conferences as the region's capital, Hohhot has the largest hotel sector in Inner Mongolia. It accounts for $153 million or 36% of the total revenues of star ranked hotels. It also has $78 million of the food-service revenue, which is 38% of the region's total. In 2008, Hohhot boasted 2 five star and 7 four star hotels. When Post visited in 2010, the numbers of four and five star hotels suggested by travel literature had risen to 4 five-star and 10 four-stars. As the easiest location to procure import foods, Hohhot hotels tend to have more import products than those of other cities.

Baotou

As an industrial town, there are some business events in Baotou, but fewer total visitors than Hohhot. But being just a one-hour flight from Beijing, many business visits are daytrips. As a consequence, Baotou's hotel sector is less developed than that of Hohhot.   In 2008, the city had only $57 million in hotel revenue of which $29 million came from food service. Travel literature claimed that there are 3 five-star hotels and 3 four-star hotels in Baotou. Discussions with the executive chefs and managers of both five and four star hotels in Baotou confirmed that the situation for western food and import items is comparable or somewhat behind that of Hohhot.

Erdos

Despite its small size and the presence of only one five star hotel, Erdos had respectable $49 million in total hotel revenues including $21 million from food service in 2008. In Erdos, the only hotel with the potential for authentic western food service is the Holiday Inn. The Holiday Inn in Dongsheng is known locally as the "State Hotel" as it is the official center for government tours and events passing through Erdos. It also accepts tourist and business guests. Peak-season rates are higher than those five-star hotels in Baotou and Hohhot. Renovations are scheduled to convert the hotel to a Crowne Plaza, adding Erdos to the list of 27 cities in mainland China with a Crowne Plaza hotel. Following renovations, the hotel will have 280 rooms and another 80 reserved for government officials. It will also expand its current western café into a real western restaurant with Brazilian and American style Barbeque and an expanded wine list. Many other hotels in Erdos have hinted at plans to upgrade during the off-season running October through April. Shangrila has purchased land in Erdos, but has delayed the start of construction.

Food Processing:

With the exception of meat and dairy processing, there is little food processing in Inner Mongolia. The small population and low level of agricultural production make the food processing sector in small compared to major agricultural provinces like Henan or Shandong. The exception to this , thanks to the large numbers of livestock and dairy cows in the province, are the dairy processing and meat sectors. With Yili and Mengniu, China's two largest dairy firms, based in Hohhot, the city accounts for 14% of China's dairy processing revenues. These firms source nearly all of their inputs locally or from other regions of China. According to a manager for the frozen products division of Yili, it is in their frozen products sector that there is the highest potential for imports. Some milk powder, whey powder, and stabilizers are being imported for use in their products. However, nuts, fruits, and natural ingredients are being sourced entirely from within China. The low prices of domestic Chinese ice cream products make it hard to source from abroad. Tastes for frozen treats are also very fickle and change from year to year making demand for any imported ingredients very unstable.

[1] Because the HRI sector is dominated by "catering trades," the figure presented for the HRI sector as whole is used to describe the size of the restaurant sector.